

National Junior College
SH2 Preliminary Examination for General Certificate of Education Advanced Level
Higher 3

ECONOMICS

Paper 1

9808/01

18 Sep 2015

3 hours 15 minutes

Additional Materials: Answer Paper

READ THESE INSTRUCTIONS FIRST

Write your student registration number and name on all the work you hand in.
Write in dark blue or black pen on both sides of the paper.
You may use an HB pencil for any diagrams or graphs.
Do not use staples, paper clips, glue or correction fluid.
DO **NOT** WRITE IN ANY OF THE MARGINS.

Section A

Answer **all** questions.

Section B

Answer **two** questions.

Begin each question on a fresh sheet of paper.

At the end of the examination, fasten all your work securely with the cover pages given.
Indicate all the required information on the cover sheet.

The number of marks is given in brackets [] at the end of each question or part question.

This document consists of 7 printed pages, including 1 blank page.

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Section A

Answer **all** questions in this section.

1 The Sharing Economy

Extract 1: The sharing economy

Why pay through the nose for something when you can rent it more cheaply from a stranger online? That is the principle behind a range of online services that enable people to share cars, accommodation, bicycles, household appliances and other items, connecting owners of underused assets with others willing to pay to use them. Dozens of firms such as Airbnb, which lets people rent out their spare rooms, or RelayRides, which allows other people to rent your car, act as matchmakers, allocating resources where they are needed and taking a small cut in return.

Such peer-to-peer rental schemes provide handy extra income for owners and can be less costly and more convenient for borrowers. Occasional renting is cheaper than buying something outright or renting from a traditional provider such as a hotel or car-rental firm. The internet makes it cheaper and easier than ever to aggregate supply and demand. Smartphones with maps and satellite positioning can find a nearby room to rent or car to borrow. Online social networks and recommendation systems help establish trust; internet payment systems can handle the billing. All this lets millions of total strangers rent things to each other. The result is known variously as “collaborative consumption”, the “asset-light lifestyle”, the “collaborative economy”, “peer economy”, “access economy” or “sharing economy”.

The sharing economy may also have environmental benefits, by making more efficient use of resources. But whatever the motivation, the trend is clear. “People are looking to buy services discretely when they need them, instead of owning an asset,” says Jeff Miller, the boss of Wheelz, a peer-to-peer car-rental service that operates in California.

As they become more numerous and more popular, however, sharing services have started to run up against snags. There are questions around insurance and legal liability. Some services are falling foul of industry-specific regulations. Landlords are clamping down on tenants who sub-let their properties in violation of the terms of their leases. Tax collectors are asking whether all the income from sharing schemes is being declared. As the sharing economy expands, it is experiencing growing pains.

Source: *The Economist*, March 2013

Extract 2: Airbnb battles: Would you stay with strangers?

Home holiday rental company Airbnb has been accused in Amsterdam and New York of facilitating “illegal hotels”. But why are so many people willing to open their doors to strangers, or indeed to stay with them?

Airbnb is a website matching up homeowners with tourists and backpackers wanting a place to stay. Set up in 2008, it's one of a wave of sites making money out of those seeking a bargain.

These websites rely on customers and hosts overcoming their fear of strangers. Many of the rentals on sites like Airbnb are whole flats, where the tourist stays

surrounded by someone else's stuff, but with the run of the place. But it is also very common to get spare rooms in flats or houses where the owner actually lives. Tourists share with somebody they know nothing about. The owner allows complete strangers into his home.

The majority of users seem to report mainly positive experiences. Yet a series of horror stories, related to the ransacking of apartments and potential identity theft in 2011, did prompt Airbnb to offer a public apology. They now provide a £600,000 insurance guarantee to their hosts, as well as a 24-hour support line.

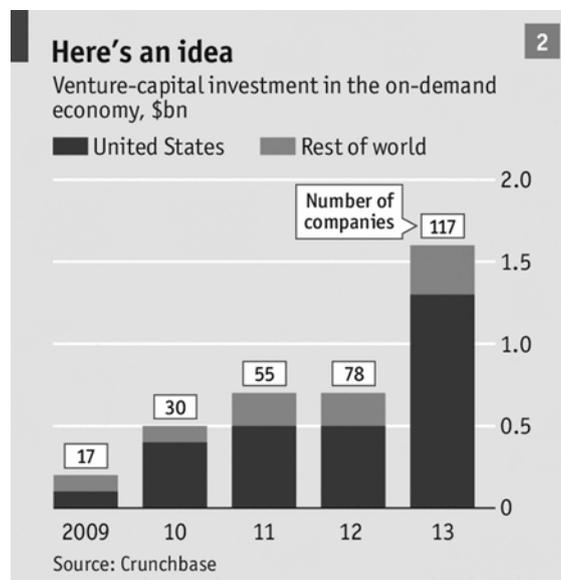
Airbnb insist that their members are safe from the problems that plague the holiday rental industry. Posting a fake property and running off with the money is impossible, they claim, because Airbnb holds payment to the owner until 24 hours after check-in.

But like so many socially oriented websites the service is principally self-regulated. Users rely on feedback scores.

"References are the most important factor," says Lopez, who has refused to host potential surfers without them. Just as consumers now regularly read customer reviews, whether going on holiday or buying an iron, users are encouraged to research each other.

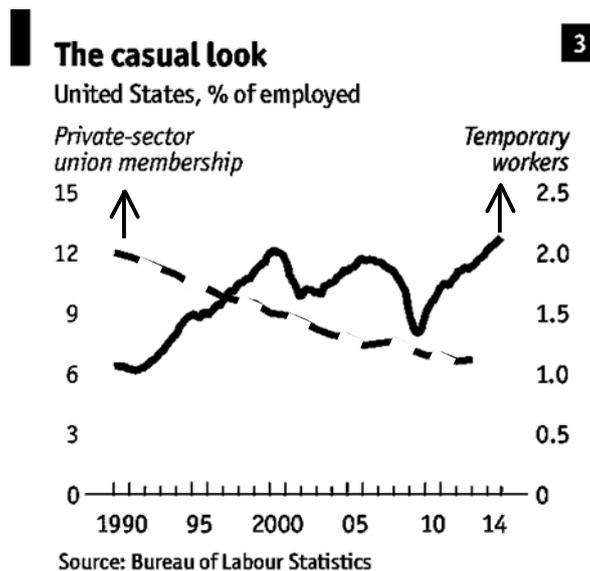
Source: *BBC News Magazine*, February 2013

Figure 1: Venture-capital investment in the on-demand economy



Source: *The Economist*, January 2015

Figure 2: Types of Employment in United States, as % of employed



Source: *The Economist*, January 2015

Extract 3: The future of work

Handy is creating a big business out of small jobs. The company finds its customers self-employed home-helpers available in the right place and at the right time. All the householder needs is a credit card and a phone equipped with Handy's app, and everything from spring cleaning to flat-pack-furniture assembly gets taken care of by "service pros" who earn an average of \$18 an hour. Founded in 2011, the company has 200 full-time employees and has raised \$40m in venture capital.

Handy is one of a large number of start-ups built around systems which match jobs with independent contractors on the fly, and thus supply labour and services on demand. The obvious inspiration of this on-demand economy is Uber, a car service which was founded in San Francisco in 2009 and which already operates in 53 countries.

Bashing Uber has become an industry in its own right; in some circles, though, applying its business model to any other service imaginable is even more popular. There seems to be a near-endless succession of bright young people promising venture capitalists that they can be "the Uber of X", where X is anything one of those bright young people can imagine wanting done for them. They have created a plethora of on-demand companies that put time-starved urban professionals in timely contact with job-starved workers.

The idea that having a good job means being an employee of a particular company is a legacy of a period that stretched from about 1880 to 1980. The companies introduced a new stability into work, a structure which differentiated jobs from one another more clearly than before, thus providing defined roles and new paths of career progress.

But this labour model started to get into trouble in the 1970s, thanks first to deteriorating industrial relations and then to globalisation and computerisation. Trade unions have lost power in the private sector, particularly in America and Britain, where legislation has reduced their ability to take action. Companies kept stricter

control of their labour costs, increasingly contracting out production in industrial businesses and re-engineering middle-management. Computerisation and improved communications then sped the process up, making it easier for companies to export jobs abroad, to reshape them so that they could be done by less skilled contract workers, or to eliminate them entirely.

This has all resulted in a more rootless and flexible labour force. Pensioners and parents wanting or needing to spend more time on child care swell the ranks of students and the straightforwardly unemployed. A recent study by the Freelancers Union, a pressure group for freelance workers, suggests that one in three members of the American workforce (and a higher proportion of younger people) do some freelance work.

The on-demand economy is the result of pairing that workforce with the smartphone, which now provides far more computing power than the desktop computers which reshaped companies in the 1990s, and to far more people. Connected to each other and to yet more data and processing power in the cloud, these devices are letting people design or find ad hoc answers to all sorts of business problems previously solved by the structure of the firm.

The way economists understand firms is largely based on an insight of the late Ronald Coase. Firms make sense when the cost of organising things internally through hierarchies is less than the cost of buying things from the market; they are a way of dealing with the high transaction costs faced when you need to do something moderately complicated. Now that most people carry computers in their pockets which can keep them connected with each other, know where they are, understand their social network and so on, the transaction costs involved in finding people to do things can be pushed a long way down.

The aim of the on-demand companies is to exploit low transaction costs in a number of ways. One key is providing the sort of trust that encourages people to take a punt on the unfamiliar. Customers worry about the quality of their temporary employees: nobody wants to give the key to their apartment to a potential burglar, or their health details to a dud doctor. Potential freelancers, for their part, do not want to have to deal with deadbeats: about 40% of freelancers are currently paid late.

On-demand companies like Handy provide customers with a guarantee that workers are competent and honest; Oisín Hanrahan, the company's founder, says that more than 400,000 people have applied to join the platform, but only 3% of applicants get through its selection and vetting process. The workers, for their part, can hope for a steady flow of jobs and prompt payment with minimal fuss. Handy's computer system also tries to schedule each worker's jobs in such a way as to minimise travel time.

But, on-demand companies like Handy are not necessarily looking at huge success, any more than the other Ubers-of-X are. There are three reasons for scepticism about their chances.

The first is that on-demand companies trying to keep the costs to their clients as low as possible have difficulties training, managing and motivating workers. MyClean, a cleaning service based in New York City, tried using purely contract workers, but discovered that it got better customer ratings if it used permanent staff. America's gathering economic recovery may make it harder for companies to attract casual labour as easily as they have done in the past few years.

The second problem is that on-demand companies seem likely to be plagued by regulatory and political problems if they get large enough for people to notice them. American on-demand companies are terrified that they will be stuck with retrospective labour bills if the courts force them to reclassify their workers as regular employees rather than contract workers (a classification which is not always consistent from jurisdiction to jurisdiction, raising the level of anxiety).

The third issue is size. The on-demand model obviously has network effects: the home-help company with the most help on the books has the best chance of providing a handyman at 10:30 sharp. Yet scaling up may be difficult when barriers to entry are low and bonds of loyalty are non-existent. It will be hard to get workers to be loyal to just one middleman. A number of Uber drivers also work for Lyft.

In many service industries it is hard to see obvious economies of scale on a national or global level. On-demand companies may find themselves stuck in a world of low margins, high promotional costs and labour churn as they struggle to attain the sort of market dominance that locks in their network advantages.

Source: *The Economist*, January 2015

Questions

- (a) With reference to data, explain the trends in private-sector union membership and temporary employment. [6]
- (b) Using game theory, explain how the presence of regulators who may impose 'regulatory and political problems' on on-demand companies may influence an on-demand company's decision to increase its scale of production. [6]
- (c) Discuss how the presence of 'lemons' will impact the growth of the sharing economy and recommend appropriate measures to address this. [8]
- (d) Assess whether the growth of the sharing economy brings about more benefits than harm to society. [10]

[Total: 30]

[Turn over

Section B

Answer **two** questions from this section.

- 2 “All science uses unrealistic simplifying assumptions. Physicists describe motion on frictionless plains, gravity in a world without air resistance. Not because anyone believes that the world is frictionless and airless, but because it is too difficult to study everything at once. A simplifying model eliminates confounding factors and focuses on a particular issue of interest.”

To what extent do unrealistic assumptions limit the usefulness of economic models? [35]

- 3 Fiat Chrysler Automobiles (FCA), a carmaker, plans to invest €5 billion in the car brand Alfa Romeo. FCA plans to rebrand Alfa Romeo with a mix of sultry Italian styling, advanced technology and extensive lifestyle advertisement.

Discuss the impact of the FCA’s rebranding on profitability, efficiency and welfare in the car market. [35]

- 4 To prevent the erosion and complete collapse of fish stocks, it is proposed that the annual quota of what can be caught in a fishery be divided up and issued as catch shares or Individual Transferable Quotas (ITQ) to each fisherman as a long-term right.

Evaluate the above policy suggestion. [35]

- 5 Some drivers seek to cheat by either not paying or underpaying their carpark fees when parking at carparks using the coupon payment system. There is an increase in individuals taking part in extreme sports such as snowboarding. However, such individuals often do not take sufficient safety measures and thus subject themselves to potential serious injuries.

Using the analysis of risk and uncertainty, explain why these actions take place and discuss how the strategies that individuals and relevant authorities may adopt in light of the risks might impact on efficiency. [35]

- 6 The level of protectionism is likely higher in developing countries than in developed countries.

Discuss the view that it is the level of protection, more than any other factors, that explains the disparity in gains from globalisation. [35]

- 7 Today, the [European] union is challenged from the inside by economic disparities, Eurosceptic parties that resent the loss of sovereignty to Brussels bureaucrats, and its own complicated rules, which hinder quick agreement on urgent issues.

Source: *The New York Times*, July 2015

Discuss the view that there is too much integration in the European Union and too little in ASEAN. [35]